

Ruwantissa Abeyratne

Regulation of Air Transport

The Slumbering Sentinels

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Preface

The airline and airport industry combined employs 4.3 million people. Additionally, engine and airframe component manufacturers employ 73,000. These industries indirectly provide employment for 5.8 million people, mostly within the supply chain that services these industries. In 2010, 2.6 million flights were operated every month providing 317 million seats. Aircraft departures are forecast to grow from 30 million in early 2013 to 60 million by 2030. Figures of the International Air Transport Association (IATA) for 2010 indicate that there were 1,568 commercial airlines; 23,844 aircraft in commercial service (19,203 jets and 4,641 turboprops); 3,846 airports servicing these aircraft which operated 26.7 million commercial aircraft movements. Airports Council International (ACI) has reported that at these airports, in 2011, worldwide traffic reached 5.4 billion passengers. Furthermore, during the first half of 2012, traffic managed to grow by a respectable 5 % in spite of global uncertainty. Regionally, strong passenger traffic growth continues in the Middle East, Latin America, Africa, and Asia, while the mature markets of North America and Western Europe growth are somewhat stalled. Airports worldwide are forecast to handle over 10 billion passengers by 2030.

At the time this book was being written, *Airbus Industrie* had reported that it had delivered 588 aircraft in 2012. It was going ahead with the A 350—Airbus’s answer to the Boeing 787 Dreamliner—which was being questioned for defects. *Airbus Industrie*, it was reported, had made a profit of 1.5 billion US dollars in 2012. Over the past decade, airlines carried 70 % more people than were carried in the previous decade, and this figure is expected to double by 2030. At its 12th Air Navigation Conference held in November 2012, the International Civil Aviation Organization (ICAO) released its new Global Air Navigation Plan, which would cope with the congestion in the skies brought about by the exponential traffic growth. Yet, not much progress had been made in the past 10 years to provide a sense of purpose and direction to the economic regulation of air transport.

Although, like many other businesses, the air transport business is sometimes beset by surprises such as unexpected economic crashes, wide-scale terrorist activity, pandemics, and natural disasters, those in the business know or ought to

know the nature of the business and have the know-how to adapt to the vicissitudes of cyclical business patterns that apply. However, they are precluded from doing so by the very nature of the air transport industry, which is driven by government policy, competition, and a race to the finish line ahead of others. Airlines are attracted by the claims of manufacturers who sport new aircraft that are more efficient, emit less greenhouse gases, and cause less noise than their competitors' aircraft. They order aircraft that, when ultimately delivered, are unable to cope with economic factors that have overtaken the circumstances prevailing when they were ordered.

Once every 10 years ICAO holds a worldwide air transport conference. The most recent of such events—the 6th Worldwide Air Transport Conference (ATConf/6)—was held in Montreal from 18 to 22 March 2013. At this conference, delegates mulled over “achievements” since the 5th Worldwide Air Transport Conference (ATConf/5), held 10 years earlier in Montreal from 24 to 29 March 2003. They noted that ATConf/5 had adopted a Declaration on Global Principles for the Liberalization of International Air Transport, 14 Conclusions and 2 Recommendations, i.e., one on the liberalization of air carrier ownership and control and the other on the future role of ICAO, including its relations with the World Trade Organization (WTO-OMC), and seven model clauses for use at States' discretion in air services agreements.

In addition, ATConf/5 adopted 67 Conclusions for inclusion in its report, which covered the full spectrum of topics and issues on the agenda. Among the Conclusions was the conference's approval for the concept and content of the Template Air Services Agreements (TASAs), one for bilateral and the other for regional situations, for use in air transport relationships. Throughout the Declaration, Recommendations, and Conclusions are numerous references to actions to be taken by States and by ICAO.

Based on these (the Declaration, Conclusions, and Recommendations), ATConf/6 decided, as further action to “meet the needs of the people of the world for safe, regular, economical and efficient air transport” (as prescribed in the Convention on International Civil Aviation), to continue to assist States in their liberalization efforts by enhancing the “market place” facility offered to States; continue to update the TASAs to keep pace with regulatory evolution; undertake and promote the development of additional training courses, regional seminars, or similar activities for the benefit of States, in accordance with available resources; continue to monitor regulatory developments, conduct studies on major issues of global importance, and provide policy guidance and assistance to States; and continue to develop relevant databases such as the Database of the World's Air Services Agreements, as well as case studies of liberalization experiences.

The questions posed by this book are as follows: Are these “clerical and administrative tasks” for ICAO that were decided on by ATConf/6 (and other such preceding conferences) sufficient to meet the needs of the people of the world for safe, regular, economical, and efficient air transport? Should ICAO not think out of its 67-year-old box and be a beacon to air transport regulators? In other words, shouldn't the bottom line of ICAO's meaning and purpose in the field of air

transport be to analyze trends and guide the air transport industry instead of continuing to act as merely a forum for global practitioners to gather and update information on their respective countries' policies for air transport? Shouldn't ICAO provide direction as do other agencies of the United Nations?

These questions are easily answered by a sensible response to the question "what are the needs of the people in this regard?" For instance, the World Bank assembles record funding to reduce poverty. The World Health Organization (WHO) is the directing and coordinating authority for health within the United Nations system. It is responsible for providing leadership on global health matters, shaping the health research agenda, setting norms and standards, articulating evidence-based policy options, providing technical support to countries, and monitoring and assessing health trends. The International Labour Organization (ILO) is the international organization responsible for drawing up and overseeing international labour standards. The International Maritime Organization (IMO) is the United Nations specialized agency with responsibility for the safety and security of shipping and the prevention of marine pollution by ships.

The word "responsibility" does not occur anywhere in ICAO's mission in air transport, as it does in other specialized agencies of the United Nations. In its web page, ICAO identifies itself as a specialized agency of the United Nations that *promotes* the safe and orderly development of international civil aviation throughout the world. It sets standards and regulations necessary for aviation safety, security, efficiency, and regularity, as well as for aviation environmental protection. Its mission is to be the global forum for civil aviation—in other words, a meeting place. Its only task is to achieve safe, secure, and sustainable development of civil aviation through the cooperation of its Member States. Again, in other words, ICAO is but an interlocutor (someone who takes part in a conversation) in global air transport, and if States do not cooperate in a particular issue, ICAO is destitute of the ability to show direction and persuade its members to follow it.

This book addresses ICAO's inability, unlike most other specialized agencies in their missions, to make a tangible difference to air transport development, through a discussion of key issues affecting the air transport industry. It will also inquire into the future of air transport regulation.

Montreal, QC, Canada
July 2013

Ruwantissa Abeyratne

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Chapter 1

The Nature and Role of ICAO

1.1 The Problem

ICAO¹ has its genesis in Article 57 of the Charter of the United Nations which states:

The various specialized agencies, established by intergovernmental agreement and having wide international responsibilities, as defined in their basic instruments, in economic, social, cultural, educational, health, and related fields, shall be brought into relationship with the United Nations in accordance with the provisions of Article 63.

Such agencies thus brought into relationship with the United Nations are hereinafter referred to as specialized agencies.²

Clearly, this provision gives ICAO “wide international responsibilities, as defined in their basic instruments. . .” In all fairness to ICAO, the basic instrument in this context—the Convention on International Civil Aviation (hereafter referred to as the Chicago Convention)—defines the aims and objectives (not mandate or responsibility) of the Organization:

The aims and objectives of the Organization are to develop the principles and techniques of international air navigation and to foster the planning and development of international air transport.³

¹ ICAO is the specialized agency of the United Nations handling issues of international civil aviation. ICAO was established by the Convention on International Civil Aviation, signed at Chicago on 7 December 1944 (Chicago Convention). One of the overarching objectives of ICAO, as contained in Article 43 of the Convention is to foster the planning and development of international air transport so as to meet the needs of the peoples for safe, regular, efficient and economical air transport. ICAO has 191 member States, who become members of ICAO by ratifying or otherwise issuing notice of adherence to the Chicago Convention. See ICAO Doc 7300/9 Ninth Edition 2008.

² Charter of the United Nations and Statute of the International Court of Justice, United Nations: New York, DPI/511-40108 (3-90) 100M, Article 57.1 and 57.2.

³ Chicago Convention, *supra*, note 1, Article 44.

In terms of economic regulation of air transport, ICAO can only “foster the planning and development of air transport”. One definition of “foster” is “to encourage or promote the development of something (typically something regarded as good)”. Another is “to nurture”. None of these definitions has even a hint of leadership, direction or responsibility ascribed to ICAO. At the International Civil Aviation Conference held in Chicago from November 1 to December 7, which gave rise to the Chicago Convention, some delegations suggested a Resolution which stated *inter alia*:

We the nations and authorities represented at this international civil aviation conference, being determined that the fullest measure of cooperation should be secured in the development of air transport services between the nations of the world, believing that the unregulated development of air transport can only lead to misunderstanding and rivalries between nations...agree that these objectives can best be achieved by the establishment of an international air transport authority which would be responsible for the operation of air services on prescribed international trunk routes...

This resolution did not see the light of day.⁴ As a result, after nearly 70 years we have a somewhat powerless Organization grappling with economic issues without the responsibility to lead its member States. This is indeed unfortunate, as a leading political scientist said:

The primary aim of inter-governmental institutions is to produce some predictability about the behaviour of its members.⁵

The key to inducing such predictability is the promulgation of Standards for the conduct of member States, an ability not bestowed upon ICAO by its authorizing instrument. However, all is not lost, due to the ingenuity of the Council of ICAO. The Council, at the 8th meeting of its 196th Session in June 2012, approved ICAO’s revised Vision and Mission Statements, as well as the new set of five Strategic

⁴ Early in the discussions during the Chicago Conference of 1944 which led to the adoption of the Chicago Convention, the Committee on Multilateral Aviation Convention and International Aeronautical Body rejected the joint proposal from the New Zealand and Australian Delegations for international ownership and operation of civil air services on world trunk routes. The rejection of that proposal indicated the tendency of the Conference away from extensive international control of air services. Of the three other plans which remained before the Committee, the United States plan called for an international aviation authority with powers limited to the technical and consultative fields; the Canadian plan aimed to set up international authority with power to allocate routes, review rates, and determine frequencies of operation, but with that power curbed by specific formulae under which the authority would operate; and the United Kingdom plan proposed more discretionary power to the international authority in allocating routes, fixing rates, and determining frequencies. It was soon obvious that none of the three plans would emerge intact from the discussions and that the final Conference proposal, if agreement were reached, would be a composite of all plans. See *Proceedings of the International Civil Aviation Conference*, Chicago, Illinois, November 1 to December 7, Vol. I, The Department of State, United States Government Printing Office, Washington:1948, at 539–540.

⁵ Gordenker (1991), p. 71.

Objectives of the Organization for 2014–2016.⁶ Accordingly, ICAO's new vision statement is "Achieve the sustainable growth of the global civil aviation system". Its Mission Statement is "The International Civil Aviation Organization is the global forum of States for international civil aviation. ICAO develops policies, standards, undertakes compliance audits, performs studies and analyses, provides assistance and builds aviation capacity through the cooperation of Member States and stakeholders". Under these two statements come ICAO's new Strategic Objectives:

- A. Safety: Enhance global civil aviation safety
- B. Air Navigation Capacity and Efficiency: Increase capacity and improve efficiency of the global civil aviation system
- C. Security and Facilitation: Enhance global civil aviation security and facilitation
- D. Economic Development of Air Transport: Foster the development of a sound and economically-viable civil aviation system
- E. Environmental Protection: Minimize the adverse environmental effects of civil aviation activities.

When one meshes the Mission Statement which states *inter alia* that ICAO develops policies, with Strategic Objective D (Economic Development of Air Transport) ICAO has legal justification to interpret the original aim in Article 44 of the Chicago Convention in a manner that justifies more responsibility and leadership in economic regulation. However, the spoiler remains the explanation of Strategic Objective D: "Foster the development of a sound and economically-viable civil aviation system". The Council has ineptly reverted back to "fostering" and that too, something called "a sound and viable civil aviation system". Apart from the ambivalence that resonates through words such as "sound" and "viable", one is bemused by the term "civil aviation system". The author has not seen any definition of this term. However, if civil aviation is considered in a systemic way, it should include all aspects of civil aviation including the aircraft involved and their manufacture and that of their components, the service providers such as ground handlers. ICAO has nothing to do with these elements.

In terms of ICAO's role in facilitating cooperation among States, the Organization is consistent with the overall role to be played by the United Nations specialized agencies as was recognized in 1945:

The international institutions of the post war period continue to be primarily instruments for the organization of cooperation between States.⁷

However, we are in the twenty-first century and the role of a United Nations agency calls for a more proactive role. This proactive role has been epitomized in the context of responses of the United Nations specialized agency thus:

⁶ Earlier, ICAO had four Strategic Objectives. They were: Safety—Enhance global civil aviation safety; Security—Enhance global civil aviation security; Environmental Protection—Minimize the adverse effect of global civil aviation on the environment; and Sustainable Development of Air Transport.

⁷ Jenks (1945), pp. 11, 19.

The evolving role of the UN specialized agencies, those quasi-autonomous UN bodies which report to the Economic and Social Council (ECOSOC) rather than directly to the General Assembly, has received less attention, despite the efforts they have made in recent years to adapt to the new demands of emergencies of all kinds by developing new priorities and ways of working, and by playing an increasingly active part in coordination mechanisms for emergency response.⁸

In the case of ICAO the best example of a complex emergency was 9/11 when aircraft were used as weapons of mass destruction. ICAO responded with aplomb, at the 33rd Session of the Assembly (Montreal, 25 September to 5 October 2001), adopting Resolution 33/1 entitled *Declaration on misuse of civil aircraft as weapons of destruction and other terrorist acts involving civil aviation*. This Resolution, while singling out for consideration the terrorist acts which occurred in the United States on 11 September 2001, and, *inter alia*, recognizing that the new type of threat posed by terrorist organizations requires new concerted efforts and policies of cooperation on the part of States, urged all Contracting States to intensify their efforts in order to achieve the full implementation and enforcement of the multilateral conventions on aviation security, as well as of the ICAO Standards and Recommended Practices and Procedures (SARPs) relating to aviation security, to monitor such implementation, and to take within their territories appropriate additional security measures commensurate to the level of threat in order to prevent and eradicate terrorist acts involving civil aviation. The Resolution also urged all Contracting States to make contributions in the form of financial or human resources to ICAO's aviation security mechanism to support and strengthen the combat against terrorism and unlawful interference in civil aviation; called on Contracting States to agree on special funding for urgent action by ICAO in the field of aviation security; and directed the Council to develop proposals and take appropriate decisions for a more stable funding of ICAO action in the field of aviation security, including appropriate remedial action.

Resolution 33/1 directed the Council to convene, at the earliest date, if possible in the year 2001, an international high-level, ministerial conference on aviation security in Montreal with the objectives of preventing, combatting and eradicating acts of terrorism involving civil aviation; of strengthening ICAO's role in the adoption of SARPs in the field of security and the audit of their implementation; and of ensuring the necessary financial means to strengthen ICAO's AVSEC Mechanism, while providing special funding for urgent action by ICAO in the field of aviation security.

The effects of this resolution were immediately seen in certain concerted efforts made both in the United States and Europe to take immediate measures to strengthen aviation security. The European Transport and Telecommunications Council, at its meeting in Luxemburg on 16 October 2001, welcomed the proposal by the Commission for a Regulation establishing common rules in the field of civil

⁸ White (1999), pp. 223–238.

aviation security.⁹ The Council invited Member States and the European Commission to contribute to the preparation for the ICAO High Level/Ministerial Conference as referred to in Resolution 33/1. In the United States, Ms. Jane Garvey, FAA Administrator, stated on 17 October 2001 at a meeting in Washington, that the United States will start using new technology called the Computer Assisted Passenger Pre-screening System which would introduce new technologies to detect plastic weapon, and greater use of explosive detection equipment.¹⁰ Ms. Garvey further added that Transportation Secretary Mineta had created a \$20 million dollar fund to explore new technologies to improve aircraft security. These grants could be used to test any new technology that leads to safer, more secure aircraft.¹¹

The operative question is, does ICAO show the same vigilance, robustness and proactivity in the economic regulation of air transport? The answer is readily available from the results of the 6th Air Transport Conference (ATConf/6) held in March 2013. At that Conference, there were several working papers discussed, but no collective strategy nor direction for future economic regulation of air transport flowed through. Even at the Pre Conference Symposium (which is now a regular practice at ICAO) held a day before the Conference the speakers spoke mostly of current trends and not about solutions or direction. Each was polarized towards its own interest (for instance UNWTO spoke of tourism and how cooperation would best work to enhance tourism and the airports did the same with their subject). This has been a trend for the past 20 years.

To the contrary, At its 12th Air Navigation Conference (AN-Conf/12) held in Montréal, from 19 to 30 November 2012, ICAO introduced its Global Air Navigation Capacity and Efficiency Plan (GANP) for the period 2013–2028. The Plan is meant to be approved by the ICAO Assembly at its sessions every 3 years. This is the fourth such Plan adopted by ICAO over the years and is based on operational objectives agreed upon by States and the aviation industry. It provides for a rolling 15 year strategic methodology and introduces Aviation System Block Upgrades (ASBUs), each of which has a 5 year time scale. The ASBUs are not overarching, nor are they an umbrella system but remain flexible modules that can be used by States in accordance with their individual operational needs. One of the salient characteristics of ASBUs is that they define technologies and procedures that are calculated to improve operational performance, particularly when the need arises for an operational problem to be solved. The ultimate aim is to achieve global harmonization and interoperability of air navigation.

Another example of ICAO proactivity was at the High Level Conference on Aviation Security, convened by ICAO from 12 to 14 September 2012 where the conference recognized that air cargo advanced information for security risk assessment is a developing area that enhances air cargo security, particularly in the context of express delivery carriers such as FEDEX, UPS, DHL Express and TNT Express who carry around 30 million shipments daily, which typically contain

⁹ Transport and Telecommunications Council, Luxemburg, 16 October 2001.

¹⁰ Garvey (2001).

¹¹ *Id.* at p. 2.

high-value added, time-sensitive cargo. These carriers guarantee the timely delivery of these vast volumes of shipments, ranging from same-day delivery to 72 h after pick-up, virtually anywhere in the world. They operate in 220 countries and territories.

The conference noted that a real risk in the area of cargo and mail security would arise when an express delivery carrier experiences a technical problem in an aircraft and is forced to transfer cargo to a passenger carrier, in which instance strict supply chain standards should be adhered to so that the risk in the transfer of cargo could be obviated.

Participants agreed that it was essential that solid standards and mutual recognition programmes be in place in order to make sure that States all along an air cargo supply chain satisfy themselves that air cargo is secure, and so let it flow unimpeded. Such standards and recommended practices should allow for the speedy transit and transshipment of legitimate air cargo worldwide, through any combination of air routes and transit or transshipment points.

These two examples contrast with the mere lip service given by ICAO to the economic regulation of air transport. The reason is clear.

1.2 The Solution

Unlike air navigation and security, which have to be globally harmonized and standardized¹² no matter what the airlines involved are, and what the States are, and which have no bearing on market economics or competition, the economics of air transport has necessarily two key players which, if they do not go hand in hand, would be isolated and lost. The two players are States and commercial air carriers, both of whom should drive their efforts towards one goal—to meet the needs of the people for regular, economic and efficient air transport. Although ICAO espouses liberalization of air transport services, it does not, and indeed has not the teeth to enforce liberalization on States. States therefore could enforce their interests and those protective interests of their national carriers in ensuring their market share, to the exclusion of competition. IATA,¹³ which is the association of the airlines on the

¹² Harmonization in this context means consistence in the various national regional and global rules, regulations procedures and practices. Standardization is conformance and compliance.

¹³ The International Air Transport Association, an association of air carriers, was formed in 1919 as the International Air Traffic Association. Encapsulated in IATA's overall mission are seven core objectives: to promote safe, reliable and secure air services; to achieve recognition of the importance of a healthy air transport industry to worldwide social and economic development; to assist the air transport industry in achieving adequate levels of profitability; to provide high quality, value for money, industry-required products and services that meet the needs of the customer; to develop cost effective, environmentally-friendly standards and procedures to facilitate the operation of international air transport; to identify and articulate common industry positions and support the resolution of key industry issues; and to provide a working environment which attracts, retains and develops committed employees.

other hand, looks after the interests of the carriers, but mostly their protection from excessive charges, rates and restrictive rules on the operation of air services.

The centrifugal point for air transport economics is competition. Both ICAO and IATA should work towards ensuring competition as a common goal of air transport. This would not only satisfy ICAO's aim under the Chicago Convention to "meet the needs of the people of the world for safe, regular, economical and efficient air transport" but also fulfil IATA's objective of moving towards "a safe, secure and sustainable air transport industry that connects and enriches our world".

First off, ATConf/6 should have been a joint ICAO/IATA Conference where both parties should have faced the aviation community on a common front as discussed above. This has never happened before. The primary product, which is the air transport product, comes first, and airports, air navigation services providers and other service providers come second. The theme of ATConf/6 should have been "*Connectivity through Competition*", whereas the theme of the Conference was "*Sustainability of Air Transport*" and the objectives of the Conference were to develop guidelines and an action plan for a global regulatory framework. Taken separately both the theme and objectives reiterate the clichés of the past decades. Is it only now that we are thinking of "sustainability of air transport"? And what exactly does it mean/Has air transport been unsustainable? And if so, why have we not had a sustained air transport system for the past 67 years? And what about the objective of "developing guidelines"? Haven't we had enough guidelines? What magical guidelines are these? And how effective are guidelines? How would a "global regulatory framework" work, when States and the airlines would pursue their own policies?

Unfortunately, once again, ICAO missed the bus and went through the ritual of convening a meeting that would come up with "guidelines". What if the Conference had an action plan, which the States bought into at the Conference, which forced their hands to achieve connectivity through competition? The European Regional Seminar of the European Civil Aviation Commission (ECAC) on 14 November 2012 suggested the adoption by ICAO of basic principles for open and fair competition and related policy instruments. At the time of writing, the most recent development on this issue was the conclusions adopted by the Council of the European Union (EU) on 20 December 2012. These conclusions recognized that the EU aviation sector and EU airlines are facing difficult challenges in a highly competitive global aviation market and, inter alia, concluded that ATConf/6 presents an opportunity for pursuing a "level playing field" through a new framework for fair competition.

Connectivity¹⁴ is a property of a network and can be defined in such a way as to constitute an indicator of the network's concentration. Therefore, connectivity is the ability of a network to move a passenger from one point to another with the lowest possible number of connections and without an increase in fare, focusing on,

¹⁴ For purposes of this book, connectivity refers to optimizing airline connections through market access.

from a commercial perspective, minimum connecting times with maximum facilitation ultimately resulting in benefits to air transport users.

This broad definition of air transport connectivity illustrates that there are several factors which enable connectivity, from availability of air transport services and airline practices, to security and facilitation procedures. In past years, the pace of liberalization has been affected by the global economic recession, which has led to a reversion toward trade protectionism in many countries. Air transport has not escaped this setback, even though in practice liberalization could be a stimulus to recovery. As of today, the vast majority of arrangements are under this type of bilateral Air Services Agreement, and the primary focus is on removing national air carrier ownership and control provisions from air services agreements and agreeing on acceptance of ownership and control provisions based on principal place of business in one or more of the participating States. Therefore, the key challenge is linked to bilateral restrictions which limit the availability of services for the air transport user. According to the industry, airline liberalization can further increase demand and ensure that the services, which are providing increased connectivity, are sustainable over the long-term. It provides the commercial freedom necessary for airlines to adjust capacity appropriately to meet changes in air travel demand. By way of example, the growth in air services between Poland and the United Kingdom (UK) since 2003 resulted in a gross domestic product (GDP) increase of 27 % for Poland, whereas the increase in the already well-served UK was a much smaller 0.5 %. These changes provide an estimated long-term boost to Poland's GDP of US\$634 million per annum. The UK also benefited, with an estimated boost to its GDP of US\$45 million per annum.

Network carriers generally offer scheduled flights to major domestic and international cities while also serving smaller cities; the carriers normally concentrate most of their operations in a limited number of hub cities, serving most other destinations in the network by providing one-stop or connecting service through the hubs. An efficient utilization of the hub allows airlines to offer better connectivity. The "hub and spoke" model is a system which enhances efficiency in transportation by greatly simplifying a network of routes. Many airlines supplement the "hub and spoke" model with codeshares, partner flights, or a small commuter airline. It should be noted that the way in which airlines price tickets can also impact connectivity, notably in the case of transit by flight stage; if a trip is sold by flight stage as opposed to origin to destination.

The lack of leadership in the economic regulation of air transport and the various "open skies" regimes that have sprung up along with mergers and acquisitions of airlines resulting in airline alliances and other commercial arrangements, is symptomatic of a crisis in law that has to be addressed. *Ex facie*, this would call for a three dimensional approach where a triage of institutions, i.e. the two parties to an agreement on market access would be refereed and regulated by a third party that would guarantee fairness of trade ensure that the conduct of trade in air transport accords with global practices of fair trade from a consumer perspective, would act as key players. This would initially mean that States veer from the parochial dogma of absolute state sovereignty and embrace the concept of sovereignty that is

consistent with globalization and accepted trade practices. In its Report to the General Assembly, the International Law Commission recommended a draft provision which required:

Every State has the duty to conduct its relations with other States in accordance with international law and with the principle that the sovereignty of each State is subject to the supremacy of international law.¹⁵

This principle, which forms a cornerstone of international conduct by States, provides the basis for strengthening international comity and regulating the conduct of States both internally—within their territories—and externally, towards other States. States are effectively precluded by this principle of pursuing their own interests untrammelled and with disregard to principles established by international law. State Sovereignty thus connotes a responsibility rather than an absolute right to do as a State deems fit within its own territory. The conduct of trade in air transport should be determined by an international political process or a “central market place”. Supiot uses the metaphor of the medieval *Marktplatz* of Brussels:

Its architectural magnificence is imbued with institutional meaning. This ancient market place is bounded by the headquarters of the institutions which endured the smooth operations of the market. The Town Hall housed the municipal authority that saw to the fairness of trade through inspection of weights and measures, while the buildings of various trades (e.g. butchers, bakers, brewers) housed the guilds that upheld the status and quality of labour, without which there could have been nothing valuable to trade. These various buildings also marked out the boundaries of the commercial sphere. If one left the market place say, to go to the courthouse or to the Royal Palace, a different set of rules applied. Indeed if the law of the market had extended to judges or to political leaders, their decisions would have been up for sale, the city would have been corrupt, and honest traders would have been unable to carry on their business there freely.¹⁶

Supiot makes a good point which is particularly applicable to the air transport analogy. The lack of central laws and regulations in market access that would otherwise ensure fairness of competition and worn out perception of sovereignty has made States control market access through a certain parochial protectionism, opening the door for various “deals” in the market.

The problem is aggravated by the fact that in modern parlance the various freedoms associated with free trade such as the freedom of establishment; the freedom to provide services; and the freedom to move capital and goods all encourage investors to go “forum shopping” so that they could opt to establish themselves in the jurisdiction that is most conducive to their interests. This allows investors to bypass the jurisdiction that they would be subject to if they were to

¹⁵ *Report of the International Law Commission to the General Assembly on the Work of the 1st Session, A/CN.4/13*, 9 June 1949, at 21.

¹⁶ Supiot (2010), pp. 151–162 at 152.

establish their businesses in their States of nationality and seek less constraining jurisdictions of their choice.¹⁷

The issue for international air transport is “what is the central market place?” The immediate answer which comes to mind, if air transport were to be treated as a trade, is the World Trade Organization (WTO). One of the most contentious issues in the world of commercial air transport today is the question as to whether the industry should embrace the trade in services regime of the World Trade Organization in preference to the currently restrictive system of the bilateral air transport agreement which entitles States to refuse permission to air carriers who apply to operate commercial air services to and from their territories. The current system is based on national treatment, where States could apply different conditions to carriers operating air services into their territories based on capacity and demand for travel at prices that are deemed acceptable to the State concerned and the travelling public. Corollaries to the current system of bilateral air transport agreement are traditionally seeped in norms requiring capacity to be primarily provided for traffic to and from the two States parties to the agreement, on the basis of “fair and equal opportunity”. Under this system, airlines are usually expected to be substantially owned and effectively controlled by a minimum percentage of the Contracting party. This affords a State the opportunity to protect the interest of its own carriers.

Air transport affects world trade in two ways: as a service by itself, directly transporting persons and freight; and as a service feeding other areas of trade mainly involving tourism and hospitality. However, it cannot be doubted that air transport affects overall economic activities of business, particularly involving cross-border trade. It is also incontrovertible that the world needs an efficient and effective air transport industry if the dual functions of the air transport service were to be sustained over time to cater to the rapidly growing demand for carriage by air of persons and goods. In order to achieve this objective, the air transport industry must be liberalized to the extent that it remains unfettered by commercial constraints. Yet, unlike most other modes of transport, air transport remains rather rigidly controlled by the need for agreements of States to permit carriers of other States into their territories as well as established percentages of national ownership of air carriers which stifle foreign investment in national jurisdictions. While at least one commentator has categorically stated that the trend towards a very liberal open skies international regime is unstoppable,¹⁸ which implicitly gives the industry the assurance that the problem would solve itself in the years to come, others have vigorously advocated that, as a panacea to the problem of rigid regulation, market access in air transport should be in the domain of a liberalized international

¹⁷ See *International Transport Workers' Federation and Finnish Seamens' Union v. Viking Line ABP and OU Viking Line Easti*, ECR 2007, I-10779 (Case C-438/05, 6 December 2007). Also, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, ECR, I-1459 case no. C-212/97, 9 March 1999. For an air transport analogy see Abeyratne (2004), pp. 585–601.

¹⁸ Doganis (2001) at 11.

regime. While the former view cannot be disputed, the latter approach brings to bear the compelling need to address the issue squarely, both in terms of whether the desirable approach would be to bring the industry from the current bilateral structure of air services negotiations into a more generalized regime and if so, what the modalities of such an exercise might entail. As to the former, it is largely a matter of political will. The latter would need some discussion on the legalities involved.

1.3 Competition

Competition strategy is composed of calculated business acts which deliberately choose a different set of activities to deliver a unique mix of value.¹⁹ National competitiveness is one of the most critical drivers of successful government and industry in every nation. Yet for all the discussion, debate, and writing on the topic, there is still no persuasive theory to explain national competitiveness. What is more, there is not even an accepted definition of the term “competitiveness” as applied to a nation. While the notion of a competitive company is clear, the notion of a competitive nation is not. The deliberations of ATConf/6 clearly brought to bear this point and implicitly called upon States to revisit their own strategies with regard to the air transport industry on the basis that the most important feature of a competitive nation is its decisive characteristic that allows its companies to create and sustain competitive advantage in particular fields—the search is for the competitive advantage of nations. Of particular concern are the determinants of international success in technology and skill-intensive segments and industries, which underpin high and rising productivity.

Classical theory supports the principle that the success of nations in particular industries based on so-called factors of production such as land, labor, and natural resources is based on the fact that nations gain factor-based comparative advantage in industries that make intensive use of the factors they possess in abundance. Classical theory, however, has been overshadowed in advanced industries and economies by the globalization of competition and the power of technology.

Any new approach must recognize that in modern international competition, companies compete with global strategies involving not only trade but also foreign investment. What a new theory must explain is why a nation provides a favorable home base for companies that compete internationally. The home base is the nation in which the essential competitive advantages of the enterprise are created and sustained. It is where a company’s strategy is set, where the core product and process technology is created and maintained, and where the most productive jobs and most advanced skills are located. The presence of the home base in a nation has

¹⁹ Porter (1998) at p. 45.

the greatest positive influence on other linked domestic industries and leads to other benefits in the nation's economy. While the ownership of the company is often concentrated at the home base, the nationality of shareholders is secondary.

A new theory for air transport must seemingly move beyond comparative advantage to the competitive advantage of a nation. It must reflect a rich conception of competition that includes segmented markets, differentiated products, technology differences, and economies of scale. A new theory must go beyond cost and explain why companies from some nations are better than others at creating advantages based on quality, features, and new product innovation. A new theory must begin from the premise that competition is dynamic and evolving; it must answer the questions: Why do some companies based in some nations innovate more than others? The most important feature of a competitive nation is its decisive characteristic that allows its companies to create and sustain competitive advantage in particular fields—the search is for the competitive advantage of nations. Of particular concern are the determinants of international success in technology and skill-intensive segments and industries, which underpin high and rising productivity.

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In the continuing debate over the competitiveness of nations, no topic engenders more argument or creates less understanding than the role of the government. Is government an essential helper or supporter of industry, employing a host of policies to contribute directly to the competitive performance of strategic or target industries? Or is it the "free market" view that the operation of the economy should be left to the workings of the invisible hand.

Both views are seemingly incorrect. Either, followed to its logical outcome, would lead to the permanent erosion of a country's competitive capabilities. On one hand, advocates of government help for industry frequently propose policies that would actually hurt companies in the long run and only create the demand for more helping. On the other hand, advocates of a diminished government presence ignore the legitimate role that government plays in shaping the context and institutional structure surrounding companies and in creating an environment that stimulates companies to gain competitive advantage.

Government's proper role is as a catalyst and challenger; it is to encourage—or even push—companies to raise their aspirations and move to higher levels of competitive performance, even though this process may be inherently unpleasant